No. 02-1551

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

ESTHER L. GAYMAN,

Petitioner,

—v.—

PRINCIPAL FINANCIAL SERVICES, INC., PRINCIPAL FINANCIAL GROUP, INC. and PRINCIPAL LIFE INSURANCE COMPANY,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

The Court of Appeals held that the complaint, which asserted claims against a mutual insurance holding company and its corporate affiliates, properly was dismissed on the ground that it did not plead circumstances constituting state action, a required element of each of Petitioner's claims. The Petition purports to raise the following questions:

1. Was the decision of the Court of Appeals inconsistent with *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936)?

2. Was the decision of the Court of Appeals inconsistent with *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406 (2003)?

PARTIES AND CORPORATE DISCLOSURE STATEMENT

All of the parties to the proceeding below are listed in the caption. Respondent Principal Financial Group, Inc. is the corporate parent of Respondent Principal Financial Services, Inc., which is the corporate parent of Respondent Principal Life Insurance Company. There is no other parent or publicly held company owning 10% or more of a Respondent's stock.

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STATEMENT OF THE CASE

This action challenged the Plan of Conversion (the "Plan") of Principal Mutual Holding Company ("PMHC"). Under the Plan, PMHC changed its form of corporate organization from a mutual insurance holding company to a stock company, a process known as demutualization. The Plan was adopted unanimously by the board of directors of PMHC on March 31, 2001. App. 66, 79. It was overwhelmingly approved by over 92% of voting policyholders of Principal Life Insurance Company ("Principal Life"), who were the members of PMHC, in a policyholder vote on July 24, 2001. App. 67. Following a public hearing, the Plan also received the approval of the Commissioner of Insurance of the State of Iowa on August 28, 2001. App. 65-95. The Plan became effective on October 26, 2001.

The purpose of the Plan was to strengthen the Principal organization by providing flexibility to raise additional capital. App. 2, 71-72. Under the Plan, eligible policyholders such as Petitioner received compensation representing 100% of the value of PMHC in the form of common stock, cash or policy credits in exchange for their membership interests in PMHC. App. 85-86.[1]

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[1] PMHC was originally formed in a 1998 transaction, which was not challenged in this action. In the 1998 transaction, Principal Life converted from an Iowa mutual life insurance company to an Iowa stock life insurance company operating within a mutual holding company structure. App. 1, 65. As a result of the 1998 transaction, Principal Life became an indirect wholly owned subsidiary of PMHC, which was an Iowa mutual holding company controlled by Principal Life's policyholders. App. 1-2. In the 2001 *(continued)*

Petitioner commenced this action in the United States District Court for the Northern District of Illinois, Western Division, on September 27, 2001. The complaint purported to assert claims against Respondents and related corporate entities (together, the "Principal Defendants") pursuant to 42 U.S.C. § 1983 for alleged violations of the Takings Clause, the Contracts Clause and the Commerce Clause arising from PMHC's adoption of the Plan.[2] Petitioner contended that the Principal Defendants were "state actors" and acted "under color of state law" in adopting and implementing the Plan, on the grounds that state law authorized the conversion and the Plan was approved by the Commissioner. App. 42, 46, 47.

The Principal Defendants moved to dismiss the complaint on the ground that (i) the conduct of the Principal Defendants challenged in the complaint did not amount to state action, and (ii) the complaint failed to state an actionable claim even if Petitioner could satisfy the state action requirement. On April 16, 2002, the District Court

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demutualization, PMHC converted into a stock company and, together with certain intermediate holding companies, merged with and into Respondent Principal Financial Services, Inc. ("PFS"), a newly formed holding company. App. 68. Respondent Principal Financial Group, Inc., a newly-formed, publicly-traded holding company, became the parent company of PFS. *Id.*

[2] In addition to the corporate entities named in the caption of the Petition, the complaint named PMHC and several other affiliates as defendants. App. 31. These additional entities no longer have any separate legal existence, as they merged into Principal Financial Services, Inc. under the Plan. App. 2, 68; *see* Iowa Code § 490.1106(1)(d) (suit against corporation extinguished in merger may proceed against surviving corporation).

granted the motion to dismiss, App. 5-8, ruling that the complaint "fails the state action requirement and . . . must therefore be dismissed." App. 8. In particular, the District Court observed that under settled law, "'[a]ction taken by private entities with the mere approval or acquiescence of the State is not state action.'" App. 6 (quoting *American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999)).

Petitioner appealed to the United States Court of Appeals for the Seventh Circuit. After briefing and argument, the Seventh Circuit affirmed the judgment of the District Court on November 22, 2002. In a unanimous opinion written by Judge Easterbrook, the panel held that the complaint failed the state action requirement. App. 1-4. Quoting from and citing settled authority of this Court, the Seventh Circuit emphasized "that 'a business is subject to state regulation does not by itself convert its action into that of the State for purposes of the Fourteenth Amendment.' . . . Nor does the need to obtain approval turn private action into public action." App. 3 (quoting *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 350 (1974); citing *American Mfrs., supra*; *Blum v. Yaretsky*, 457 U.S. 991 (1982); and *Flagg Bros. v. Brooks*, 436 U.S. 149 (1978)). The court further observed that the challenged transaction was initiated by a private company, adopted by its board of directors and approved by its policyholders. App. 4. The court rejected Petitioner's attempt to constitutionalize a company's decision to change its corporate form. The court stated:

> All corporate management is subject to control under state law (including judicial review of managers' competence and loyalty); some decisions require advance approval; yet it would be

> preposterous to say that all corporate acts therefore are state acts.

App. 3-4.

Petitioner sought both panel rehearing and rehearing en banc. The petition was denied, as all the judges on the panel voted to deny rehearing, and no judge in regular active service called for a vote on rehearing en banc. App. 9.

Petitioner then sought and obtained an extension of time to file this petition for certiorari, in order for it to coincide with the petition for certiorari in *Tancredi v. Metropolitan Life Insurance Co.*, No. 01-1542. *Tancredi* involved similar claims against another company brought by the same lawyers, and its dismissal had recently been affirmed by the Second Circuit. *See Tancredi v. Metropolitan Life Ins. Co.*, 316 F.3d 308 (2d Cir. 2003). The petitions for certiorari in this case and in *Tancredi* were both filed on April 21, 2003.

REASONS FOR DENYING THE WRIT

There is nothing remarkable about the decision below, which flows obviously and directly from this Court's settled case law on the requirement of state action. Petitioner's contention that the case is inconsistent with *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936), and *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406 (2003), is frivolous. *Phillips Petroleum* did not even involve the issue of state action. Moreover, *Phillips Petroleum* and *Brown*, unlike the present case, involved challenges to state laws that imposed mandatory obligations on private conduct. Here, however, Petitioner challenged a privately initiated and implemented transaction that

was merely permitted under state law. Under this Court's settled precedent, mere permission by the state does not transform private conduct into state action.

In any event, if Petitioner genuinely believed that the Plan did not provide adequate compensation, ample remedies were available under state law. No constitutional issues are implicated.

I.
The Decision Below Raises No Issues Warranting This Court's Review, As It Follows Directly from This Court's Settled Precedent on the Issue of State Action.

The decision below raises no question of federal law that has not been settled by this Court. Rather, the decision follows easily from a straightforward application of this Court's precedents on the state action requirement.

The complaint purports to state claims under 42 U.S.C. § 1983 for violation of the Takings Clause of the Fifth Amendment as applied to the states by the Due Process Clause of the Fourteenth Amendment, and for violation of the Contracts Clause of Article I, § 10.[3] A necessary element of each of these claims is "state action," which requires that the alleged constitutional deprivation be undertaken by a "state actor." *See, e.g., American Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 50 (1999) (under Fourteenth Amendment, state action requires that

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[3] The Complaint also purported to raise Commerce Clause claims, which also require state action, but Petitioner does not raise those claims in the Petition.

the alleged constitutional deprivation be undertaken by a "state actor"); *Blum v. Yaretsky*, 457 U.S. 991, 1002 (1982) (Fourteenth Amendment "erects no shield against merely private conduct"); *Rendell-Baker v. Kohn*, 457 U.S. 830, 838 (1982) ("under color of law" requirement of 42 U.S.C. § 1983 means "the same thing as the 'state action' required under the Fourteenth Amendment"); U.S. Const., Art. I, § 10 ("No *State* shall . . . pass any . . . Law impairing the Obligation of Contracts") (emphasis added); *see also Brown*, 123 S. Ct. at 1421 (rejecting Takings Clause claim to extent alleged taking resulted from private action rather than state action).

Petitioner cannot satisfy the state action requirement because the Principal Defendants are private entities and not state actors. The starting point for the analysis of allegations of state action is to "identif[y] the specific conduct of which the plaintiff complains"—here, the adoption and implementation of the Plan. *American Mfrs.*, 526 U.S. at 51. Petitioner's claims plainly fail because that purely private decision is not "fairly attributable to the state," *id.* at 50, as the Court of Appeals correctly recognized.

Petitioner seeks to characterize the adoption and implementation of the Plan as state action because it was authorized by state law and received regulatory approval. As this Court expressly has held, however, "[a]ction taken by private entities with the mere approval or acquiescence of the State is not state action." *American Mfrs.*, 526 U.S. at 52; *accord, e.g., Blum*, 457 U.S. at 1004 ("Mere approval of or acquiescence in the initiatives of a private party" pursuant to statute does not transmute that private initiative into state action); *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 357 (1974) (approval by state

agency of private company's business decision "does not transmute" that private initiative into state action). The Plan was proposed by PMHC's management, adopted unanimously by PMHC's board of directors, approved by a vote of PMHC's members, and implemented by PMHC and the other Principal Defendants through an initial public offering and the distribution of consideration to PMHC's members. In holding that the state action requirement was not satisfied, the Court of Appeals reached the only conclusion possible under this Court's settled precedents. App. 3-4; *see, e.g., American Mfrs.*, 526 U.S. at 52 (test is whether state "has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State").

Petitioner misstates the holding of *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982), in arguing that state action is established merely by showing that the defendant has exercised a right or privilege created by the state. Pet. 9. In fact, *Lugar* holds that *in addition* to the exercise of a right or privilege created by the state, state action also requires that

> the party charged with the deprivation must be a person who may fairly be said to be a state actor. This may be because he is a state official, because he has acted together with or has obtained significant aid from state officials, or because his conduct is otherwise chargeable to the State. Without a limit such as this, private parties could face constitutional litigation whenever they seek to rely on some state rule governing their interactions with the community surrounding them.

Id. at 957; *see also Flagg Bros. v. Brooks*, 436 U.S. 149, 156 (1978) (warehouse operator's sale of plaintiff's goods, though authorized by statute, was not state action).

Petitioner's attempt to portray a private corporation's decision to reorganize as an exercise of the state's "reserved power," Pet. 9, also is insufficient to establish state action under the settled precedent of this Court. To establish state action on the ground that a private entity is exercising a state function, a plaintiff must show that the private entity is exercising core governmental functions that are "the *exclusive* prerogative of the State." *Rendell-Baker*, 457 U.S. at 842 (quoting *Jackson*, 419 U.S. at 353 (emphasis added by Court)) (holding that education of special-needs children was not state action under "public function" theory, even when funded by state); *see also Blum*, 457 U.S. at 1011 (same, with regard to nursing home receiving public funds). Private decisions regarding the organization of private corporations, though authorized by state law, do not fall into this very narrow category. As the Court of Appeals recognized, "[t]oday anyone can incorporate and mergers may be approved by majority vote." App. 4; *see also Tancredi*, 316 F.3d at 313 ("The management of a corporation is not a public function; and a state's permission of a corporation to organize itself in a particular manner is not the delegation of governmental authority"). The decision to undertake such private corporate changes is not even the type of decision that the state commonly makes, much less a decision that is inherently the exclusive prerogative of the state. *See Blum*, 457 U.S. at 1011; *Rendell-Baker*, 457 U.S. at 842; *Jackson*, 419 U.S. at 352-53.

II.
The Decision Below Does Not Conflict With Any Decision of Another Federal Court of Appeals or of This Court.

Petitioner's suggestion that there is a conflict among the federal Courts of Appeals on the state action issue in this case, Pet. 4, is incorrect. Every federal Court of Appeals to have considered the question has concluded that a corporate reorganization, where authorized by statute but initiated by the corporation itself, does not constitute "state action" or "governmental action" under this Court's precedents. *See Cranley v. National Life Ins. Co.*, 318 F.3d 105, 111-13 (2d Cir. 2003); *Tancredi*, 316 F.3d at 312-14; *Broad v. Sealaska Corp.*, 85 F.3d 422, 430-31 (9th Cir. 1996); *Ordower v. Office of Thrift Supervision*, 999 F.2d 1183, 1187 (7th Cir. 1993); App. 1-4. Although Petitioner claims that these cases conflict with *Ohio State Life Insurance Company v. Clark*, 274 F.2d 771 (6th Cir. 1960), the *Clark* case did not consider or address the issue of state action. Review by this Court is unnecessary in view of the unanimity of the federal Courts of Appeals that have considered this point, and the absence of any difficult question of law.

Petitioner also has no basis for the assertion that the decision below "disregard[ed] as outdated" this Court's decision in *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936), or construed subsequent cases as "*sub silentio* overruling" the *Phillips Petroleum* decision. Pet. i. In fact, the opinion of the Court of Appeals does not even cite *Phillips Petroleum*, which has no bearing on the issue of state action.

Phillips Petroleum involved a challenge to the constitutionality of a state statute imposing liability on corporations for injuries sustained by their employees as a result of the negligence of co-employees. The Court held that this law, which "substitutes the rule of respondeat superior for the common-law fellow-servant rule," was reasonably related to government interests and consistent with both the Contracts Clause and the Equal Protection Clause. 297 U.S. at 636. As part of its ruling, the Court observed that the state's reserved power to amend laws affecting corporations defeated the petitioner's Contracts Clause claim. *Id.* at 634. The Court also noted that "[t]he reserved power is not unlimited and cannot be exerted . . . to take property without compensation." *Id.*

Contrary to the impression Petitioner attempts to create, Pet. 10, the presence of state action was not in dispute in *Phillips Petroleum*. Moreover, that case involved the mandatory imposition of liability by state law. Here, in stark contrast, Petitioner challenged a corporate decision initiated and implemented by a private corporation. As this Court's cases make clear, a private decision to exercise a right granted by statute is not "state action," absent coercion or significant encouragement that demonstrates that the decision is attributable to the state. *See, e.g., American Mfrs.*, 526 U.S. at 52.[4]

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[4] For similar reasons, Petitioner's reliance on *Coombes v. Getz*, 285 U.S. 434 (1932) and *Looker v. Maynard*, 179 U.S. 46 (1900), is misplaced. Like *Phillips Petroleum*, neither of those cases arose under 42 U.S.C. § 1983, and neither of them addressed the issue of state action.

Accordingly, Petitioner cannot satisfy the state action requirement. The *Phillips Petroleum* language cited by Petitioner addresses only substantive restrictions that the Takings Clause or Contracts Clause places on actions taken *by the state*. That language is irrelevant where, as here, a private party has initiated and undertaken the challenged conduct. Petitioner's claim of a "direct conflict" between *Phillips Petroleum* and the decision below is therefore baseless.

For similar reasons, Petitioner's assertion that the decision below conflicts with this Court's decision in *Brown v. Legal Foundation of Washington*, 123 S. Ct. 1406 (2003), is completely meritless. In *Brown*, the Court rejected a challenge to a Washington state-court rule, which required certain escrowed funds to be held in an account subject to the state's "interest on lawyers' trust accounts" ("IOLTA") program, if the funds could not generate net interest for the client's benefit. The interest on the IOLTA account was paid to a foundation for public purposes. *See* 123 S. Ct. at 1421. The Court "*assume[d]* that . . . [petitioners'] interest was taken for a public use" under this procedure. *Id.* at 1419 (emphasis added). The Court concluded, however, that the petitioners lost nothing of value, because the IOLTA rules applied only when the funds could not generate net interest for their owner. *Id.* at 1419-20. The Court held, therefore, that the amount of "just compensation" was zero. *Id.*

Petitioner's reliance on the assumption in *Brown* that a taking had occurred has no bearing on the issues in this case, because the mandatory IOLTA requirement in *Brown*—unlike PMHC's decision to demutualize—clearly involved state action. In *Brown*, the State of Washington *required* all lawyers and limited practice officers ("LPOs")

to place escrowed funds in IOLTA accounts whenever they determined that the funds could not generate net interest for the client. Here, by contrast, the state has not required any company to demutualize. As described above, PMHC's demutualization was initiated by its management, adopted by its board of directors and approved by a policyholder vote. PMHC was entirely free not to pursue a conversion under the demutualization statute if it so chose.[5]

As *Brown* itself makes clear, action that would violate the Takings Clause if undertaken by the state raises no constitutional concern if it is undertaken by a private party. Indeed, the petitioners in *Brown* argued that the IOLTA rule might cause lawyers or LPOs to deposit funds in IOLTA accounts mistakenly, even if the funds could generate net income. *Id.* at 1420. The Court, however, rejected the notion that this amounted to a Takings Clause violation, holding that the likelihood of erroneous deposits by private actors did not undermine the validity of the IOLTA process created by the state. *Id.* at 1421. The Court observed:

> The [Washington State IOLTA] Rules . . . unambiguously require lawyers and LPOs to deposit client funds in non-IOLTA accounts whenever those funds could generate net earnings for the client. . . . Thus, if the LPOs who deposited petitioners' money in IOLTA accounts could have

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[5] For the same reason, the remaining Takings Clause cases cited by the Petitioner (Pet. 13-15), which presuppose coercion by the state, are inapposite.

> generated net income, the LPOs violated the court's Rules. Any conceivable net loss to petitioners was the consequence of the LPOs' *incorrect private decisions rather than any state action.*

Id. (emphasis added).

Here, too, any claim by the Petitioner that compensation distributed by PMHC under the Plan was inadequate was not the result of any action by the state. The Plan was a privately initiated and implemented decision. Moreover, Iowa's laws regulating demutualization are designed to require that policyholders receive adequate compensation, and provide that any plan of demutualization must be "fair and equitable to policyholders." Iowa Code § 508B.3. Accordingly, as with the mistaken IOLTA deposits addressed in *Brown*, any conceivable harm to policyholders from an allegedly unfair demutualization would be the result of the demutualizing company's putatively "incorrect private decisions, rather than any state action." *Brown*, 123 S. Ct. at 1421. For this reason, Petitioner has no viable constitutional claim.

III.
Policyholders' Interests Are Fully Protected by State Law.

Finally, Petitioner's assertion that the decision below "affect[s] significant and valuable property rights," Pet. 16, is incorrect. Even putting aside the widely recognized fact that membership interests in a mutual organization lack tangible economic value in the absence of a demutu-

alization,[6] state law governing demutualizations amply protects any interests that policyholders may have.

Any policyholder who believed that the Plan failed to provide fair and equitable compensation in exchange for policyholders' membership interest, or otherwise failed to meet the applicable legal requirements, had an opportunity to object to the Plan orally or in writing at a public hearing before the Commissioner. App. 78; *see also* Iowa Code §§ 508B.7, 508B.8. Furthermore, any policyholder who believed the Plan was improperly approved could have sought judicial review in state court. *See* Iowa Code § 508B.14; *see also* App. 2 (Seventh Circuit opinion, noting that "[d]issenting policyholders . . . might have asked the state courts to review the transaction for compliance with state law but did not").

Petitioner's suggestion that policyholders were somehow denied justice is therefore completely unfounded. The matters of corporate organization that Petitioner challenges are entrusted to the business judgment of the company's board of directors and to the judgment of the

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[6] *See, e.g., Paulsen v. Commissioner*, 469 U.S. 131, 138-40 (1985) (value of membership interests in mutual savings bank was "practically, zero"); *Society for Savings v. Bowers*, 349 U.S. 143, 150 (1955) (same); *Tancredi v. Metropolitan Life Ins. Co.*, 149 F. Supp. 2d 80, 86-87 & n.22 (S.D.N.Y. 1991) (citing cases holding that mutual company membership interests, whether in insurance company or savings bank, are "too insubstantial" to constitute property), *aff'd*, 316 F.3d 308 (2d Cir. 1993), *petition for cert. filed*, 71 U.S.L.W. 3699 (U.S. Apr. 21, 2003) (No. 02-1542). Petitioner's contractual rights in her insurance contract are expressly preserved by the Plan and are unimpaired as a matter of law. *See* Iowa Code § 508B.9.

voting policyholders, subject to regulation by the state for policyholders' protection. No issues of federal law warranting this Court's attention are implicated.

CONCLUSION

For all of the foregoing reasons, Respondents respectfully request that the Court deny the Petition.

Respectfully submitted,

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